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Article 6

Bankruptcy - Effect of Receipt of Note as Evidence of, or in Payment of, a Tort Claim Otherwise Barred From Discharge in Bankrupty

Arthur H. Seidel

RECENT DECISIONS

Bankruptcy—Effect of Receipt of Note as Evidence of, or in Payment of, a Tort Claim Otherwise Barred from Discharge in Bankruptcy—Plaintiff finance company loaned certain sums to the Auto Service Sales Company, a corporation managed by the defendants. The loan was secured by certain automobiles in possession of the sales company. Upon discovering several false representations by the defendants concerning the extent of this security plaintiff complained and the defendants as corporate officers executed a cognovit note containing an additional personal guaranty by each of the defendants. Plaintiff obtained a judgment on the note and instituted a subsequent garnishment action which was stayed to await the final determination of defendants' bankruptcy proceedings. After defendants' discharge in bankruptcy the garnishment action was continued; defendants claimed there had been a discharge of the liability. *Held:* The court may not go behind the record of the first judgment to determine the nature of defendants' liability; and acceptance of a note for a liability, which may have sounded in tort, waived the tort and reduced the liability to one upon contract. *Swano Finance Corporation v. Haase,* 252 Wis. 12, 30 N.W. (2d) 82, (1947).

Section 17 of the Bankruptcy Act provides that certain classifications of provable debts shall be exempt from discharge.[1] The nature of these exceptions indicates a Congressional intention to relieve the honest debtor from his financial obligations, but that certain liabilities originating from a degree of moral turpitude should not be discharged by proceedings under the Act. The statute is remedial and should in general be construed in favor of the bankrupt debtor,[2] however, a question arises whether this approach should be used when a liability exempt from discharge under Section 17 is changed in form to a liability that would ordinarily be discharged. Where a judgment is obtained upon a tort claim it is uniformly held that the court will look behind the judgment to determine whether the judgment debtor

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[1] U.S.C.A., sec. 35(a) as amended June 22, 1938, c. 575, sec. 1, 52 Stat. 851, which contains the following provisions concerning tort liability: "A discharge in bankruptcy shall release a bankrupt from all of his provable debts, ... except such as. . . . . (2) are liabilities for obtaining money or property by false pretenses or false representation, or for willful and malicious injuries to the person or property of another, ... (4) where created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; . . . . .".

[2] In re Noble, (D.C. Colo. 1941) 42 F.Supp. 684; Shepard v. McDonald, (C.C.A. 9th, 1946) 157 Fed.(2d) 467.

is discharged[3] and this depends upon whether the tort is a wilful or malicious wrong.[4]

If instead of a reduction to a judgment a note is accepted as evidence of, or in payment of, a tort claim the courts are willing to go behind the note to determine the nature of liability. The preponderance of decisions indicate that the note is a mere acknowledgment of the tort, therefore a waiver of the tort liability has not been made and the tort may be alleged upon a suit based on the note.[5] In one case where a waiver was found the court held the action was nevertheless not barred,[6] presumably because of the policy behind the Bankruptcy Act.[7] Wisconsin, however, indicates an adherence to the strict doctrine of waiver, but it may not have fully considered the problem. In the principal case[8] the decision rests partially upon a waiver of tort liability upon acceptance of the note. Plaintiff's briefs stated that no waiver had been intended, but the Court held adversely with little discussion. The Court points out that a party having an action in either tort or contract and suing upon contract can not thereafter recover damages on tort.[9] It is felt that this rule should not bar allegations of tort coupled with a suit upon the note so as to limit the application of Section 17 and the intent of Congress.

Another group of cases is where a judgment is obtained upon the note prior to bankruptcy, presenting a dual intervention between the original liability and the force of discharge. The weight of authority will allow the court to look behind the judgment to the record in order to determine whether there was a discharge.[10] A minority view holds

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[3] 6 Am. Jur. 830, Bankruptcy, sec. 528. ". . . The court will look behind the judgment and consider the entire record; and the actual fact disclosed thereby as the basis for the liability of the judgment debtor will govern." Globe Indemnity Co. v. Granskov, 246 Wis. 87, at 91; 16 N.W. (2d) 437 (1944).

[4] Globe Indemnity Co. v. Granskov, *supra,* (judgment based upon negligent performance of ones duties as deputy discharged); In re Wegner, (C.C.A. 7th, 1937), 88 Fed.(2d) 899, (judgment on negligent driving discharged); Re Pacer, (D.C. N.Y. 1934), 5 F.Supp. 439, (judgment on assault and battery not discharged).

[5] Symmes v. Rollins, 39 Ga. App. 53, 146 S.E. 42, (1928); Madison Twp. v. Dunkle, 114 Ind. 262, 16 N.E. 593, (1888); Field v. Howry, 132 Mich. 687, 94 N.W. 213, (1903); Gregory v. Williams, 106 Kan. 819, 189 P. 932, (1920); Blumberg v. Henne Co., Tex. Civ. App., 5 S.W.(2d) 1015, (1928); Guernsey Newton Co. v. Napier, 151 Wash. 318, 275 P. 724, (1929); Brown v. Hannagan, 210 Mass. 246, 96 N.E. 714, (1911); Donahue v. Conley, 85 Cal. App. 15, 258 P. 985, (1927); Kilbourn v. Mechanics Loan & S. Co., 175 Ga. 146, 165 S.E. 76, (1932).

[6] Mathewson v. Naylor, 18 Cal. App.(2d) 741, 64 P.(2d) 979, (1937).

[7] *Supra,* note 1.

[8] Shawno Finance Co. v. Haase, 252 Wis. 12, 30 N.W.(2d) 82, (1947).

[9] The Court cited Huganir v. Cotter, 102 Wis. 323, 78 N.W. 423, (1899), where the Brankruptcy Act was not involved.

[10] Rice v. Guider, 275 Mich. 14, 265 N.W. 777, (1936); Mutual Auto Ins. Co. v. Gardner, 315 Mich. 689, 24 N.W.(2d) 410, (1946); Donald v. Kell, 111 Ind. 1, 11 N.E. 782, (1887); Aetna Casualty and S. Co. v. Sentilles, La. App.,

the judgment on a note to be a waiver of the tort,[11] thus restricting the court to the judgment alone. Connecticut has recently overruled an earlier decision upholding the minority view and allowed the creditor to present evidence outside of either the judgment or the record in order to determine the nature of the debt. In this instance the Court argued that it is an accepted principle that one may go behind a note and that a judgment does not alter the character of indebtedness, therefore evidence extraneous to the record should not be precluded; to do so would be to defeat the intention of Congress.[12] Wisconsin is in accord with the weight of authority,[13] but incidental findings of tort appearing in the record will not bar a discharge.[14]

ARTHUR H. SEIDEL

Federal Taxation—Ownership for Federal Income Tax Purposes and for Federal Gift Tax Purposes Distinguished — Taxpayer created two irrevocable trusts, with others as trustees, consisting of a securities trading account to be managed and operated under his direction for the benefit of his three children. Taxpayer reserved the right to use the corpus for marginal trading. It was provided that he would make good any losses which resulted from such trading out of his own earnings, and such losses were to be made good to him out of the first profits that accrued from future transactions. The litigation involved taxpayer's gift tax liability as grantor of the trusts for the marginal trading profits. *Held:* The marginal trading profits are not taxable gifts as they accrued immediately and directly to the trusts. Taxpayer had no economic interest in such profits, and any losses suffered would have been suffered by the trusts. What taxpayer contributed were his services which he could withhold at any time, but he could not withhold any of the profits accruing from the marginal trading. Taxpayer can not give what he can not withhold. *Commissioner v. Hogle, 165 F. (2d) 352 (C.C.A. 10, 1947).*

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160 S. 1949, (1935); Bronx County Trust Co. v. Cassin, 170 Misc. 962, 10 N.Y.S.(2d) 986, (1939); Scott v. Corn, Tex. Civ. App., 19 S.W.(2d) 412, (1929).

[11] Ford v. Blackshear Mfg. Co., 140 Ga. 670, 79 S.E. 576, (1913); Consolidated Plan v. Bonitatibus, 130 Conn. 199, 33 A.(2d) 140, (1943).

[12] Fidelity & Casualty Co. of N.Y. v. Golombosky, 133 Conn. 317, 51 A.(2d) 817, (1946).

[13] Shawno Finance Co. v. Haase, *supra.* "It is true that in determining whether the liability of a judgment debtor is dischargeable in bankruptcy under Section 17(a) of the Bankruptcy Act, the court will look behind the judgment and consider the entire record, and the actual fact disclosed thereby as the basis for adjudicating liability will govern.", Estate of Weil, 249 Wis. 385, 24 N.W. 662, (1946).

[14] Klatt v. Helming, 248 Wis. 139, 21 N.W.(2d) 261, (1945).